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AUTHOR	Ruppert, Sandra S.
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ABSTRACT

This booklet provides an overview of the principal concepts of pension portability. Pension portability has become an area of increasing interest since a lack of portability discourages veteran teachers from seeking teaching opportunities in other districts or states. This obstacle can force teachers to abandon the profession, thus contributing to the increasing shortage of qualified teachers. The text examines the major types of pension plans, the current status of plans covering K-12 educators, and recent state actions to improve pension portability for teaching professionals. It also includes steps designed to help state policymakers ensure a fair and open process for modernizing retirement systems for a changing teacher work force. Some of the areas that the document focuses on are the structure of defined-benefit plans and defined-contribution plans and the advantages and disadvantages of such plans. It also examines the status of pension plans covering K-12 teachers and claims that by shortening defined-benefit vesting periods, by simplifying defined-benefit service-credit purchases, by instituting interstate or intrastate reciprocity agreements, and by adopting defined-contribution plans, state legislators can improve pension portability. Legislators also must identify clear state goals, keep changes targeted to specific issues, and allow adequate time for implementation. (Contains glossary and 16 endnotes.) (RJM)

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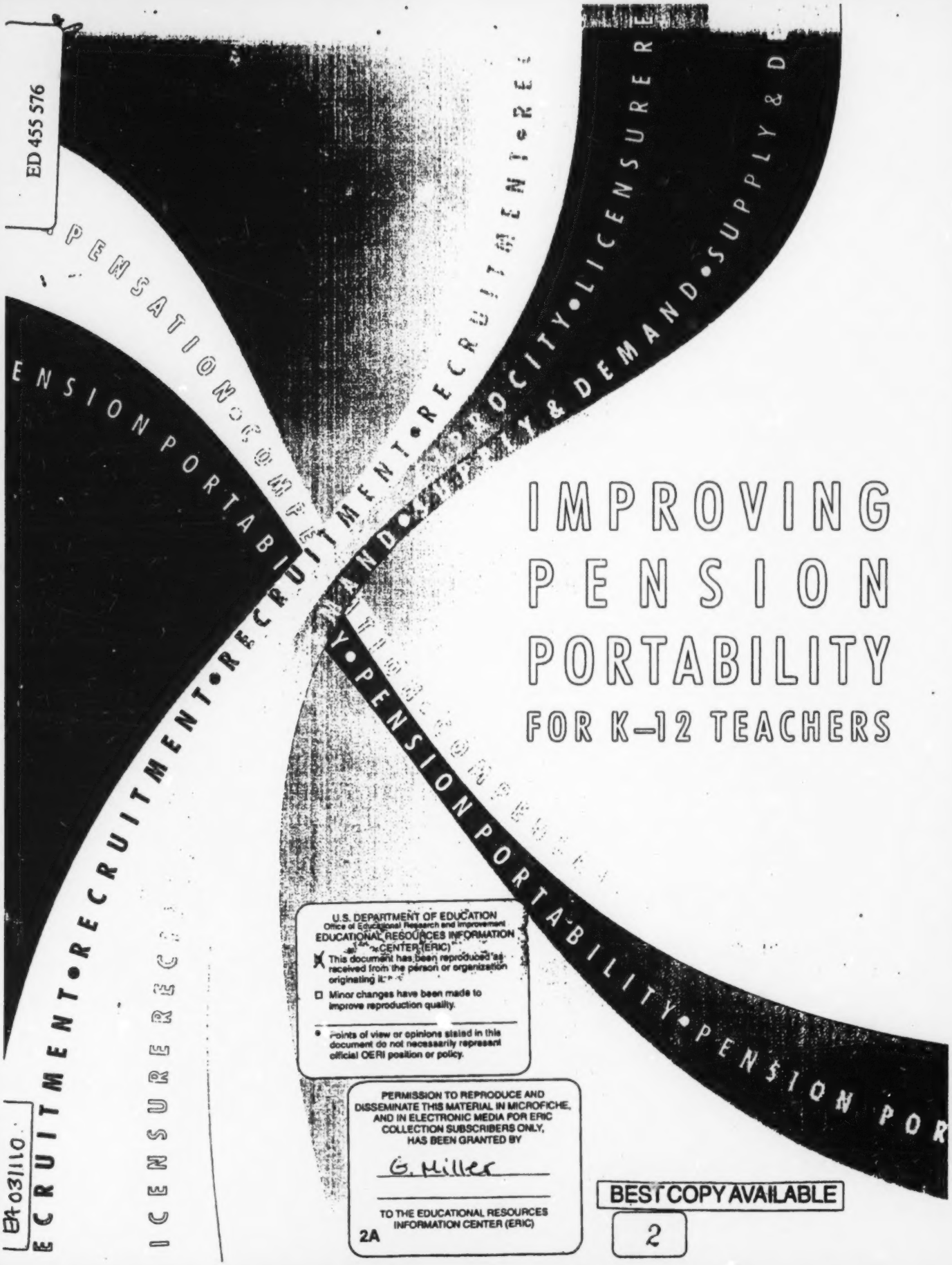
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SHEEO

The State Higher Education Executive Officers is a nonprofit, nationwide association of the chief executive officers serving statewide coordinating boards and governing boards of postsecondary education. The principal mission of SHEEO is to support continuing efforts to create and sustain excellent systems of higher education. SHEEO provides professional development opportunities for members and their senior staff, it facilitates the exchange and rapid dissemination of policy information among the states, and it conducts periodic studies and projects to promote effective policy development and implementation. Forty-nine states, the District of Columbia, and Puerto Rico are members.

NCSL

The National Conference of State Legislatures serves the legislators and staffs of the nation's 50 states, its commonwealths, and territories. NCSL is a bipartisan organization with three objectives:

- To improve the quality and effectiveness of state legislatures,
- To foster interstate communication and cooperation,
- To ensure states a strong, cohesive voice in the federal system.

The Conference operates from offices in Denver, Colorado and Washington, D.C.

Since 1908, the governors have worked through the National Governors Association to deal collectively with issues of public policy and governance. The association's ongoing mission is to support the work of the governors by providing a bipartisan forum to help shape and implement national policy and to solve state problems.

The association works closely with the Administration and Congress on state-federal policy issues, serves as a vehicle for sharing knowledge of innovative programs among the states, and provides technical assistance and consultant services to governors on a wide range of management and policy issues.

The Center for Best Practices is a vehicle for sharing knowledge about innovative state activities, exploring the impact of federal initiatives on state government, and providing technical assistance to states. The Center works in a number of policy fields, including education.

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IMPROVING PENSION PORTABILITY FOR K–12 TEACHERS

Sandra S. Ruppert
Educational Systems Research

February 2001

A Report of the SHEEO Project
Enhancing the Teaching Profession: The Importance of Mobility to Recruitment and Retention

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This document is available electronically on the SHEEO web site at www.sheeo.org. Printed copies are available for $10, including postage, from the SHEEO office. The complete package of project documents, including three strategy briefs and a *Compendium of Resources on Teacher* Mobility, is available for $30.

SHEEO provides a 30 percent discount for orders of 10 or more of one publication. Orders must be prepaid or accompanied by a purchase order. Credit cards are not accepted

State Higher Education Executive Officers
707 Seventeenth Street, Suite 2700
Denver, CO 80202-3427

Telephone: 303-299-3686
Fax: 303-296-8332
E-Mail: sheeo@sheeo.org

FOREWORD

Recent research has demonstrated that student learning depends most of all on the knowledge and skills of classroom teachers. While national studies project a need for 2.2 million new teachers over the next 10 years, supply and demand data also show that the current distribution of teachers is uneven with critical shortages appearing in urban and rural districts and specific subject areas. In view of increased expectations for quality teachers and demands for more teachers, it is vitally important that public policies make teaching a more attractive profession. Every child in every school should have the opportunity to learn from a well-qualified teacher.

Despite the compelling nature of this situation, a review of established policies and countless anecdotes indicates that state and local employment and benefits policies often work against this priority. They restrict employment opportunities for experienced teachers and pose formidable barriers to new recruits.

Veteran teachers are discouraged from seeking teaching opportunities in other districts or states by the lack of reciprocity in licensing, restrictions on pension portability, and the unwillingness or inability of most districts to pay teachers for accrued experience. Such barriers create problems for experienced teachers whose families relocate or who wish to take advantage of market opportunities. As a result, many good teachers leave the profession prematurely. Similarly, many talented individuals are discouraged from considering teaching as a career. This applies both to college students preparing to start their careers and to the many skilled individuals looking for mid-career changes.

Enhancing the Teaching Profession: The Importance of Mobility to Recruitment and Retention, a two-year project sponsored by the State Higher Education Executive Officers (SHEEO) and funded by the Ford Foundation, seeks to promote the recruitment and retention of accomplished teachers by facilitating their mobility across districts and states. The project is based on the premise that the quality of the teaching profession will be enhanced by: (1) licensing policies that focus on capability, not locally idiosyncratic regulation, and (2) personnel policies that give teachers the freedom of movement enjoyed by other high-status professions. It has produced a series of publications that identify resources and analyze the policies and initiatives that affect employment opportunities for new and veteran teachers.

Resource Compendium

The ***Compendium of Resources on Teacher Mobility*** describes nearly 100 national, regional, and state resources, including data sources, initiatives, web sites, studies, and reports related to teacher mobility. The topics covered include: teacher supply and demand, compensation, hiring and recruitment, licensure requirements and credential reciprocity, pension portability, and general resources. The *Compendium* highlights the wealth of quality information available on each of these issues, but also sheds light on gaps between what studies suggest will make the profession more attractive and actual policies and practices at state and local levels. Co-published by SHEEO and the North Central Regional Education Laboratory (NCREL), the *Compendium* was developed by Alene Bycer Russell and Sandra S. Ruppert, with assistance from Rhetta Detrich.

Strategy Brief Series on Teacher Mobility

A strategy brief series was developed and co-published by SHEEO, the National Conference of State Legislatures (NCSL), and the National Governors Association (NGA). The briefs provide reviews of current state policies and initiatives in three areas: recruitment and hiring, license reciprocity, and pension portability. The three documents analyze states' interests and goals in achieving a high quality teacher workforce and identify specific strategies targeting these goals. These studies indicate that policies that enhance teacher mobility also help to keep good teachers in the profession and provide greater opportunities to recruit teachers to schools where they are in greatest need.

Teacher Recruitment: Staffing Classrooms with Quality Teachers by Eric Hirsch of the National Conference of State Legislatures identifies current strategies developed by states to recruit and hire quality teachers. The strategy brief describes innovative efforts to attract students and mid-career professionals to the teaching profession, as well as incentives to lure well-qualified and experienced teachers to hard-to-staff schools and subject areas where teachers are in short supply. The author offers several suggestions for strengthening the recruitment of high quality teachers, including better collection and analysis of teacher supply and demand data, integration of recruitment initiatives into comprehensive strategies to address teacher quality, and evaluation and modification of recruitment policies based on effective practices.

Solving Teacher Shortages through License Reciprocity by Bridget Curran, Camille Abrahams, and Theresa Clarke of the National Governors Association Center for Best Practices examines state teacher licensure requirements and the extent to which there is reciprocity of these credentials across state lines. For policymakers and education leaders interested in facilitating the portability of teacher licenses, the authors offer suggestions for ensuring that only qualified teachers are working in schools and for creating incentives that will facilitate the recruitment and hiring of experienced teachers in communities where there is critical need and high demand.

Improving Pension Portability for K-12 Teachers by Sandra S. Ruppert of Educational Systems Research provides an overview of key concepts related to pension portability. The study examines major types of pension plans, the current status of plans covering K-12 educators, and recent state actions to improve pension portability for teaching professionals. In addition to a glossary of terms, the brief offers suggestions to help state leaders ensure fair and open processes for modernizing retirement systems for a changing teacher workforce.

The resource compendium and the strategy briefs offer policymakers, researchers, and educators information and approaches to guide research and focus policy discussions on particular aspects of teacher mobility. Together, these documents provide a wide range of policy tools and options to enable state education leaders and policymakers to enhance the recruitment and retention of high quality teachers across the country. We hope they are helpful to your work and, on behalf of our organizations, we welcome opportunities to work with you to accomplish your goals.

Esther M. Rodriquez
Associate Executive Director
SHEEO

Eric Hirsch
Education Program Manager
NCSL

Bridget K. Curran
Senior Policy Analyst
NGA Center for Best Practices

Sabrina W.M. Laine
Director, Evaluation & Policy
Information Center
NCREL

BACKGROUND

Teacher quality is increasingly a focus of state and national attention as states seek to improve student performance with challenging academic content standards and high-stakes testing for K-12 students. At a time when demand for highly qualified teachers is growing, however, many states are also experiencing severe teacher shortages. An accelerating rate of teacher retirements, growing student enrollments, and mandated class size reductions are contributing to a record number of teaching vacancies, particularly in certain subject areas and in hard-to-staff rural and urban schools.

States that either do not prepare enough teachers in high demand areas or fail to retain them in sufficient numbers to meet current or anticipated shortfalls are forced to recruit teachers from other states. The current tight labor market ensures that states will face stiff competition in attracting the most highly qualified teachers. In what the media have referred to as "bidding wars," states from coast to coast are vying for the best teachers by offering incentives such as signing bonuses, low interest housing loans, and reimbursement of moving expenses.

Despite generous inducements, however, veteran teachers may be reluctant to leave their current positions if their retirement benefits are not fully portable. *Pension portability* means that workers can take their retirement benefits with them when they change employers and that the value of their benefit will not diminish simply because they've changed jobs. Because of the design and structure of different retirement systems covering public school teachers, K-12 educators may face a reduction in benefits when moving between jobs. This affects not only teachers who move from one state to another but also teachers who change jobs within the same state if the state has more than one retirement system and reciprocity between systems has not been established. For new teachers or for individuals considering entering the teaching profession, pension portability is also vitally important even though retirement may be several years down the road. Given our increasingly mobile workforce, guaranteed pension portability is a valuable feature of any competitive compensation package.

The absence of pension portability for K-12 teachers is not a new concern for state policymakers. In the mid-1980s, a national task force on teaching as a profession noted that the current retirement structure penalizes teachers who move from one retirement system to another and encouraged states and districts to take action "to eliminate the obstacles to career mobility for teachers." [1] Today, although pension portability is garnering more attention from state policymakers, most states still lack a recognized policy for dealing with an increased probability that teachers will move to other locations and change employers over the course of their teaching careers.

In many states, K-12 teachers are enrolled in a separate "teachers" retirement plan that covers only teachers and in some cases other educational personnel. While state legislatures have enacted new laws in recent years to enhance pension portability for select groups of workers, they have been slow to develop policies that respond to the mobility needs of teachers. One reason may be the underlying assumption that the teaching profession is not very mobile – that is, teachers tend to take and keep jobs in close proximity to where they live or have attended college. Unfortunately, it is difficult either to verify or refute this

SUMMARY

Lack of adequate pension portability can pose formidable barriers to career mobility and impede states' efforts to recruit and retain the high caliber of teachers needed to meet teacher shortages. State policymakers should consider what they could do to enhance pension portability for current and future generations of teachers.

This strategy brief provides an overview of principal concepts related to pension portability and examines major types of pension plans, the current status of plans covering K-12 educators, and recent state actions to improve pension portability for teaching professionals.

It also includes next steps designed to help state policymakers ensure a fair and open process for modernizing retirement systems for a changing teacher workforce. A glossary of key terms (as indicated by italicized words or phrases) is included.

assumption as most states lack good information on the number of teachers hired in a given year who have taught previously in another state.

Most public retirement systems were established decades ago. Initially conceived as a way to recruit younger workers who would commit to a career in public service, the plans were designed to recognize longevity by rewarding employees for years of continuous service. But mobility patterns are changing and, as a result, retirement systems need to change. Lack of adequate pension portability can pose formidable barriers to career mobility and impede states' efforts to recruit and retain the high caliber of teachers they need. State policymakers should consider what they could do to enhance pension portability for current and future generations of teachers.

MAJOR TYPES OF PENSION PLANS

Although pension plans can vary widely in design and funding, two basic types of plans exist: defined benefit (DB) and defined contribution (DC). Each type can be described in terms of its unique structure, employee and employer advantages and concerns, and workforce implications.

Defined Benefit (DB) Plans

Structure of Defined Benefit Plans

Under a *defined benefit (DB) plan*, an employee's future retirement income is determined by a benefit formula specific to the retirement plan. Typically, the amount of income is based on years of service with the employer and final average pay multiplied by a benefit percentage factor. For example, an employee covered by a pension with a 2 percent benefit formula would know that after 30 years of service his or her pension would replace 60 percent of final average pre-retirement income. DB plans are designed to provide monthly income benefits over the life of the employee. Investment earnings also help provide funding. Each plan sets a normal retirement age when benefits can begin without any reduction in the amount for greater than expected longevity.

TWO TYPES OF PENSION PLANS

- **Defined Benefit** (DB): Benefit is determined by a specific formula
- **Defined Contribution** (DC): Benefit is determined by salary contributions and investment earnings

The actual cost of the defined benefit plan will be the amount of these lifetime payments made to all retired participants. To fund these costs in advance, actuaries estimate future investment earnings on the plan's assets, future salary growth, mortality experience, job turnover rates and other projected factors. A funding rate is usually established as a percentage of compensation covered by the plan. In the public sector, the cost of retirement benefits is often shared with the employee who must contribute to the plan.

Advantages of Defined Benefit Plans

Under a DB plan, employees are guaranteed a specific level of lifetime income that they can directly relate to their pre-retirement earnings, such as the 60 percent replacement in the example above. The employee is not exposed to any downside risk from investment earnings since the plan must provide the determined benefit. The governing boards responsible for defined benefit plans take advantage of the investment expertise of professional money managers. Many of the DB plans that cover K-12 teachers provide for benefit increases in retirement related to changes in the cost of living. Special disability retirement

and survivor benefits are often provided as part of the retirement plan. About 75 percent of state and local government employees also participate in Social Security with the remainder covered by the plan of their employing jurisdiction only.

Concerns under Defined Benefit Plans

Portability is often cited as a concern. For employees who leave before meeting their plan's *vesting* requirement, usually only their contributions and earnings as specified by the plan will be refunded to them. For employees who leave after they have established a vested interest in their employer's portion of the pension benefit, the amount of future pension income remains fixed based on fewer years of service and lower earnings at termination than if they had stayed until normal retirement. States generally, however, offer opportunities for employees to purchase *service credit* that allows them to buy years of service that they would otherwise lose because of various types of ineligibility, including insufficient years to vest in a benefit earned in another jurisdiction. Additionally, while the risk of investment loss is eliminated for DB plans, any added investment gains that may reduce the cost of the plan do not directly benefit the employee by increasing the amount of pension income. Alternatively, if a pension plan's projected benefits exceed the projected assets available under the plan, it has an unfunded liability that must be borne by the employer or state.

Workforce Implications of Defined Benefit Plans

The structure of a DB plan tends to backload its benefits so that the greatest increase in benefit levels occurs for workers in their older ages. As such, these plans reward long service. Many of the DB plans that cover K-12 teachers provide for unreduced retirement benefits if workers retire before age 65, such as age 55 with 25 or 30 years of service. In those states facing teacher shortages, these provisions may serve to increase the number of teachers who need to be replaced, and the DB plan can be easily enhanced to encourage early retirement through incentive programs that provide added years of service and age to an employee. The cost of such incentives can be spread out over the plan and funded over a period of years or may reduce any surplus funding in the plan. Younger teachers, who generally do not focus on retirement benefits decades in the future, may fail to appreciate the plan's role as part of their compensation package. At the same time, older workers, who are in DB pensions that cap their years of service recognized by the plan, may feel that their continuing to work adds little value to their future security.

PENSION PLAN CONSIDERATIONS

- Structure of the Plan
- Plan Advantages
- Plan Concerns
- Workforce Implications

Defined Contribution (DC) Plans

Structure of Defined Contribution Plans

Under a *defined contribution (DC) plan*, a specified amount of salary is contributed to the retirement account for each employee. The contributions are invested, usually according to the direction of the employee, in annuities, mutual funds, or other financial accounts that are managed by investment professionals. The amount of income at retirement will depend on the contributions made, the investment earnings achieved at the age of retirement, and the income option selected. For example, a 10 percent DC plan over a 30-year career would likely replace 38.4 percent of final earnings assuming that salary increased by 5 percent, investments achieved a 7 percent rate of return,

and a single life *annuity* was chosen at age 65. The actual cost of a defined contribution plan is the specified contribution rate; thus, the impact on future budgets is clear. Employers would not encounter any unexpected personnel benefit costs since their funding obligations are satisfied when the contributions are made.

Advantages of Defined Contribution Plans

The nature of the individual accounts in DC plans can provide for greater portability than with DB plans. Higher than expected investment experience directly increases the employee account balance, adding more benefits. Individuals have the choice to invest retirement assets according to their personal risk preferences. DC plans provide an almost seamless transfer between retirement plans at termination through rollover and direct transfers to the next employer's plan. Both employer and employee can share the cost of the plan. Any employee contributions can be made on a pre-tax basis. The employer's cost is easy to predict and there is no possibility of incurring unfunded liabilities for prior service. The value in an account of the DC plan is payable as a survivor benefit.

Concerns Under Defined Contribution Plans

Both DB plans and Social Security provide a guaranteed stream of income. A DC plan, in contrast, does not guarantee a specific monthly benefit. Instead, the retirement benefit is based on the value in an employee's account at retirement. The amount of pension money available to a DC plan participant depends on how well the investments in the plan performed. Clearly, the employee bears the investment risk of losses and potential for gain. If an annuity is purchased at retirement, the monthly income can be either fixed or variable (that is, continue to change with values in underlying market investments). Generally, retirement income under a DC plan is not automatically increased with inflation, but individuals may select options with a lower starting income level, such as inflation related annuities and variable annuities, in the hope of providing greater benefits in future years. Disability programs cannot be easily set up under DC plans because, unlike DB plans, they are not designed to share risk. Participants in DC plans need to fully understand the financial risks and benefits of their investment choices. Employers, therefore, will need to educate employees about investing. Additionally, if a DC plan does not provide a sufficient level of benefits, political pressure for increased public contributions or for replacement with a DB plan may occur. In 1967, the Tennessee Teachers' Retirement System was converted from a DC plan to a DB plan, which resulted in an unfunded liability that took decades to finance.[2]

Workforce Implications of Defined Contribution Plans

Defined contribution retirement plans more directly involve employees in this aspect of their compensation. Regular financial statements and benefit projections repeatedly reinforce that their pension is a beneficial asset in the future. For younger workers who are uncertain of their long-term career path, a DC plan is especially attractive because it allows mobility. The nature of interest compounding can result in adding significant value, so early participation in DC plans needs to be encouraged. Increased values in DC plans can encourage older workers to delay retirement so they can let the

money continue to grow. Retirement benefits before the "normal retirement age" requires a reduction in monthly income that the plan cannot subsidize directly. Due to tax code contribution limits for DC plans, any early retirement incentive for DC plan participants must be arranged separately.

STATUS OF PENSION PLANS COVERING K-12 TEACHERS

The majority of elementary and secondary teachers, like most other public sector employees, are covered under defined benefit (DB) plans. The notable exception exists within the higher education market. Most of these employees have defined contribution (DC) plans as their primary retirement benefits. DC plans for higher education have developed over the last 20 to 30 years, as college administrators realized that in order to attract outstanding faculty, they would have to offer more flexible retirement benefits. As of 1998, 47 states either had enacted legislation for or had in place DC plans for higher education employees. As discussed later, only one state as of Fall 2000 had adopted a mandatory DC plan covering K-12 teachers; several other statewide or local retirement systems have adopted DC components, either as an optional plan or as part of a "hybrid" DC/DB plan.

Within states, different pension systems may cover different groups of public sector employees. The National Education Association (NEA) surveys the 100 largest of these plans.[3] Several of these plans are statewide, but others focus on locally managed public systems. The groups of employees covered in a plan vary from plans that only cover teachers in K-12 to others where teachers are included in a plan covering all public employees.

In attempting to clarify trends and summarize pension plan provisions, the following features pertain to statewide plans that cover K-12 teachers:

- Unlike in the private sector, states and other public employers have the option to elect coverage under Social Security for their employees. K-12 teachers in 13 states are not covered by Social Security and rely solely on their state pension system.
- The benefit factor used by each state in its defined benefit formula can vary but a majority falls within a certain range. For those plans with employees in Social Security, the factor generally ranges between 1.5 percent and 2.0 percent, while in those states not covered by Social Security, the benefit factor falls between 2.0 percent and 2.5 percent.
- The contribution to fund these benefits spans an even greater range with the majority of employers contributing in excess of 7.5 percent of payroll and employee contributions, for the most part, falling in the 5 percent to 10 percent of salary range.
- All plans increase benefits after retirement either on an ad hoc basis or by a formula related to the Consumer Price Index (CPI) changes. Some of the plans also provide retiree health care coverage.

CURRENT STATUS OF PLAN COVERAGE

- **Most K-12 teachers are covered under defined benefit plans.**
- **Most higher education faculty are covered under defined contribution plans.**

RECENT STATE ACTIONS TO IMPROVE PENSION PORTABILITY

Shorter vesting periods under defined benefit plans

When teachers are vested, it means they have satisfied some minimum service requirement and have a right to a pension at retirement, regardless of whether they remain in covered employment. Employees who leave a job prior to achieving vesting generally are entitled only to their own and not their employer's contributions to the retirement plan.

In recent years, states have been shortening vesting periods for public sector employees. In 1998, 61 percent of the 100 major retirement systems surveyed by the NEA required five or fewer years of service to vest compared to 53 percent in 1994. The statewide pension systems in Arizona and Wisconsin offer immediate vesting. Still, 35 percent of the plans reviewed in 1998 used a 10-year or greater vesting standard. During 1999-2000, the trend toward shorter vesting periods continued with Maine and Vermont each reducing their vesting requirements from 10 years to 5 and Florida reducing its from 10 years to 6 for certain groups of employees.

In addition to shortening vesting periods, some states are enhancing benefits for short-term and mobile employees by allowing partial vesting. For example, if employees leave before vesting they are eligible only for a refund of the employee contribution with interest. In South Dakota, however, although the vesting period is five years, employees who work fewer than three years receive 75 percent of employer contributions in addition to their employee contributions. If they work more than three years, they receive 100 percent.

Simplified retirement service credit purchases under defined benefit plans

Credited service is the employment period that is counted toward a pension. Through purchase of retirement service credit, employees who have forfeited credit in some way, either because they took leaves of absence or left employment before vesting, may buy back credit. Without purchase of service credit arrangements, a person could work under several retirement systems during his or her career, losing retirement benefits with each move.

ACTIONS TO IMPROVE PENSION PORTABILITY

- **Shorten DB Vesting Periods**
- **Simplify DB Service Credit Purchases**
- **Interstate or Intrastate DB Reciprocity Agreements**
- **Adopt DC Plans**

Provisions for the purchase of service credit are very common. According to the National Council for Teacher Retirement (NCTR), as of 1998, 47 of the 50 state retirement systems that serve K-12 teachers allowed experienced educators moving into a state to purchase retirement credits for public teaching service outside the state.[4] However, each retirement system may have its own set of requirements for the purchase of service credits. Systems may differ in terms of the types of prior service that can be purchased, the amount that must be paid, the maximum amount of service that can be purchased, and the payment options available.

According to NCTR, several states, including Arizona, Illinois, Michigan, South Dakota, and Texas have made it easier for retirement system members to purchase service credits, allowing for installment payments or pre-tax purchases. In other states, such as Colorado, Indiana, and North Dakota, participants may purchase service credits with funds transferred to the state's plan from another qualified plan.

Interstate or intrastate portability agreements under defined benefit plans

A few states have authorized their retirement systems to transfer a participant's credit to other retirement systems. "*Intrastate reciprocity*" refers to transfers authorized between retirement systems in the same state. "*Interstate reciprocity*" or "*Interstate portability*" refers to transfers authorized between systems in different states.

In a June 1999 survey, NCTR asked its 73 member retirement systems whether they were authorized to allow interstate and intrastate portability of pension benefits.[5] According to NCTR, as of 1999, Missouri and Texas were the only states that allowed the retirement system in the state to enter into agreements with comparable systems in other states for the purpose of transfer of creditable service. Intrastate reciprocity agreements are more common. Of the 45 systems (representing 38 states) that responded to the survey, 26 reported they allow intrastate transfers. Georgia, Louisiana, Massachusetts, Michigan, Montana, New York, North Dakota, Ohio, Rhode Island, Virginia, and West Virginia are among the states that have authorized state and certain local systems to enter into intrastate agreements. In reporting the survey findings, however, NCTR noted that respondents might have interpreted the question differently depending on the structure of their retirement systems. As discussed earlier, states differ in terms of their plan coverage. Some states, for example, may have multiple plans to cover different groups of public employees while other states may have only a single statewide plan covering all state and local employees.

Adoption of defined contribution plans

During 1998, legislation to convert statewide DB plans for K-12 teachers into DC plans was introduced in 13 states, according to NCTR.[6] The majority of bills were not enacted; those that passed affected narrow bands of employees or expanded coverage of existing DC plans.

According to the National Conference of State Legislatures (NCSL), which tracks major policy issues in state pension and retirement legislation, the major development during 1999-2000 was the adoption of optional DC plans in several states.[7] Three states – Florida, Ohio, and South Carolina – adopted optional DC plans that affect K-12 teachers. Florida's new DC plan is open to all current and new members of the Florida Retirement System; in Ohio, all new members of the State Teachers Retirement System and those with less than five years of service can join the plan; in South Carolina, only new members of the South Carolina Retirement System are eligible.

Several states, including Arizona, Georgia, Kansas, Maine, Montana, and Utah, have authorized studies of DC options in recent years. In 1999-2000, Iowa and New Mexico decided to undertake pension reform studies, the results of which may have implications for improving pension portability for K-12 teachers in those states. Iowa's study has a specific charge to explore options for improving pension portability while New Mexico will target pension reform strategies designed to improve recruitment and retention of public school teachers.[8]

PUTTING IT ALL TOGETHER: PENSION REFORM IN FLORIDA

An anticipated shortfall of 23,000 public school teachers needed to fill Florida's classrooms was one of several pressing concerns prompting the Florida Legislature to initiate a study of possible changes to the state's retirement system as a way to attract and retain talented public employees. The result was legislation that created an optional defined contribution plan and enhanced benefits for both short-term and longer-tenured employees under the existing defined benefit plan. Florida's experiences with pension reform are noteworthy not only for its outcomes, which included improved pension portability for K-12 teachers and other public employees, but also more importantly, for the way in which the process was conducted.

The legislative study committee charged with making recommendations for pension reform began its work by developing a set of principles to guide its efforts. The "Principles of Florida Retirement System Reform" outlined three primary goals: provide levels of income that are comparable with other retirement systems, promote consistency in the terms and benefits for public employees, and keep benefits competitive.[10] Among other things, one objective to be achieved under these goals was to improve portability in the pension system to "not unduly penalize workers who change jobs."

The committee commissioned two surveys as part of its data collection. One survey included public employees, who were currently members of the Florida retirement system, approximately one-quarter of whom were K-12 teachers.[11] The survey's purposes were to measure employees' overall satisfaction with the system, learn how well employees understood their current benefits, and determine interest in alternatives to the current defined benefits program. Results indicated that most respondents felt they had a good understanding of the vesting, service, and age requirements, but not of the benefit calculation, the amount to be received, how the plan was funded, and the options for receiving payment. Additionally, most respondents expressed interest in having a choice between two retirement plans.

The second survey included education majors at Florida State University in order to determine the possible role of retirement benefits in prospective teachers' decisions about a teaching career.[12] Findings revealed that future teachers expected to be mobile and ranked health and retirement benefits ahead of salary as the most important factors influencing their decisions about a teaching position. Like the public employees, education majors preferred a retirement plan that would combine a "guaranteed level of income at retirement" with a "portable plan."

Information gathered through these two studies played a significant role in the development of the study committee's recommendations to the Florida Legislature and is reflected in the resulting legislation passed in 2000. House Bill 2393, to be effective in 2002, establishes an optional defined contribution plan, which will be open to public school teachers as well as other state and local employees. As part of the same legislation, state policymakers also took steps to enhance the existing defined benefit plan by increasing employer contribution rates and reducing the number of years required to vest in the system. Additionally, HB 2393 required an education process for employees considering changing to the DC plan. To ensure employees are comfortable with their retirement choice, the law gives them two opportunities to switch from one plan to another.

To date, only West Virginia has set up a mandatory DC plan for its K-12 educational employees. All employees hired on or after July 1, 1991 are members of the DC plan. The existing DB plan has remained in place for teachers hired before the cutoff date and who choose not to switch to the DC plan.

Most states and localities cannot terminate a DB plan and force existing employees into a DC plan. West Virginia could require newly hired employees to participate in the new DC plan; however, other states, including Florida and Ohio, have chosen to offer employees in the existing DB plan the option of transferring to the new DC plan. Thus, a state or locality that adopts a new defined contribution plan, in addition to an existing defined benefits plan, must bear the administrative costs of managing and maintaining both types of plans.

Two states – Indiana and Washington – have implemented "hybrid" plans that combine features of both DC and DB plans. For example, under the Washington plan covering K-12 teachers, the employer-funded portion of the plan is a defined benefit while the employee-funded portion is a defined contribution. The state legislature accomplished two objectives with the new plan: provide employees with enhanced pension portability and create more flexibility in financial planning for retirement.[9]

STATE EFFORTS TO ADOPT DC PLANS

- **In 1999-2000, 3 states – Florida, Ohio and South Carolina – adopted optional DC plans for K-12 teachers.**
- **Indiana and Washington have implemented "hybrid" plans that combine both DB and DC features.**
- **To date, only West Virginia has established a mandatory DC plan for K-12 educational employees.**

NEXT STEPS FOR STATE POLICYMAKERS

In many states, public pension plans are multi-billion dollar funds covering tens of thousands of state and local employees. With so much at stake, even relatively minor adjustments or enhancements to the existing plan can have potentially serious financial implications for employers, employees, and taxpayers alike.

Given these circumstances, legislative and pension system analysts and staff members, who were interviewed for this strategy brief because of their first-hand knowledge of pension reform issues, offered this advice: Efforts to enhance pension portability are best viewed, not in isolation, but as part of a comprehensive pension reform strategy aimed at crafting policies to attract and retain a high quality workforce. In addition, those interviewed suggest that state policymakers approach the issue of pension portability in context and with care. Even in states where multiple plans cover smaller groups of employees and contain fewer assets and liabilities, caution is the watchword. Other considerations that can help to ensure an open process for pension reform include the following recommendations.

NEXT STEPS FOR STATE POLICYMAKERS

- **Identify clear state goals**
- **Keep changes targeted to specific issues**
- **Use reliable data to inform policy decisions**
- **Weigh options carefully**
- **Allow adequate time for education and implementation**

Identify clear state goals for pension reform

From a state perspective, a fundamental purpose of any retirement system is to attract and retain a high caliber workforce in a cost-effective manner. Beyond that, the goals for pension reform may vary according to a state's priorities. For example, one of Florida's goals for pension reform was to provide levels of income comparable to other public retirement systems. In South Dakota, provisions under the state retirement system were redesigned to meet the goal of improved

benefits for short-term and mobile employees. Montana's legislature set the following goals for its pension reform efforts: increased plan flexibility and portability, employee investment choices, and a component retaining a specific benefit in retirement.

At the outset, state policymakers should strive to be clear in identifying explicit state goals and be open to innovation in how they craft solutions to achieve those goals. It is important to bear in mind, however, that there are alternative ways to achieve the same goal. Solutions developed in one state may not be work well in another state or locality.

Keep changes targeted to specific issues

A legislative analyst who has worked with several states on pension reform issues offered state policymakers this advice: "Don't make sweeping changes to your pension system unless it's absolutely necessary. Keep changes targeted to specific issues." Through adjustments and enhancements to the design and structure of pension systems, state policymakers have at their disposal a set of policy tools they can use to temporarily shape the teaching workforce. For example, states faced with the prospect of severe teacher shortages can look to retirement plan enhancements as a way to retain working teachers longer or to attract recently retired teachers back into the workforce. California, South Carolina, and Texas are among the states that recently have begun allowing retired teachers in high demand areas to return to the classroom at full salary while continuing to collect their pensions. Alternatively, Nevada has proposed providing teachers with an extra year of retirement credit if they are willing to teach in hard-to-staff schools.

For states looking to recruit teachers from across state lines or to improve pension benefits for short-term or mobile teachers, policymakers can choose from various options for enhancing pension portability. As discussed earlier, depending on particular circumstances, a state could decide to shorten vesting periods, ease the purchase of service credits, establish reciprocity or portability agreements, or adopt an optional or defined contribution plan.

Use reliable and objective data to inform policy decisions

State policymakers considering changes to their current retirement plans may want to look for ways to rise above the politics and special interests often inherent in the reform process. Legislative and retirement system analysts stress the importance of involving disinterested parties "who don't have a dog in the fight" to assist in gathering relevant objective data. Many state legislatures establish formal legislative study committees to coordinate this function and then to review and recommend policy changes.

The National Conference of State Legislatures recommends that legislatures consider forming permanent pension review bodies to analyze problems on an ongoing basis.[13] Created in 1968, the Ohio Retirement Study Council serves such a purpose and has the advantage of being able to look at issues over the long term and to make recommendations directly to the legislature. Members of the council include state legislators and appointees of the governor; the director of the state retirement system serves in an ex officio capacity.

Weigh all the options carefully

When it comes to deciding among various policy options or plan types, it is important to recognize that one size does not fit all. State policymakers should consider evaluating the advantages and disadvantages of each viable option before making their decisions about which alternative will best meet state needs in a cost-effective manner. In addition to an analysis of cost issues associated with each option, an equally important consideration is the need to balance the concerns and interests of different constituencies. Montana's recent experience with pension reform provides a useful model for ensuring an open and fair process.[14] House Bill 90, which set goals for a new or modified retirement system, also expressly required the involvement of "employers, employees, unions, plan administrators, policymakers, and other interested parties." To allow for their input, Montana conducted public hearing and focus groups with different constituent groups. These forums helped to build trust among the groups, identify their concerns, and prioritize the policy issues, which led to a better informed and less fractious decisionmaking process for state policymakers.

Allow adequate time for education and implementation

Employees often do not have a clear understanding of the costs and benefits associated with their pension plans or of the impacts that job changes may have on their benefits. Yet, pension reform can result in employees being required to assume greater responsibility for their retirement choices even though retirement may be years in the future. This can be especially the case when a state decides to offer an alternative retirement plan to the one already in place. In a study conducted for the Teachers Insurance and Annuity Association–College Retirement Equities Fund (TIAA-CREF), researchers examined the pension choices made at a large public university where faculty can choose between DB and DC retirement plans.[15] The findings suggest that "pension enrollment decisions were made rather casually, with limited information, and without much consultation with retirement planners." Consequently, it is not surprising that 17 percent of the faculty surveyed also indicated they were "not at all confident" in their pension decision.

These results underscore the importance of ensuring that pension reform changes are accompanied by an adequate period of employee education. Montana's legislation explicitly calls for a "pre-conversion and post-conversion education plan" that would enable employees to make better personal choices.[16] Likewise, retirement systems also need adequate time to implement changes resulting from pension reform. As one legislative analyst pointed out, retirement systems may need to undergo a "shift in the organizational culture" to adapt to new roles and responsibilities.

In sum, enhancing pension portability for a changing teacher workforce should be part of a state's comprehensive strategy for modernizing its pension system. Within that context, policymakers should identify clear state goals for pension reform and ensure that proposed changes target specific issues. Options – supported by reliable data – must be weighed carefully and coupled with adequate time for education and implementation.

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GLOSSARY

Annuity – A specified income payable at stated intervals for a fixed or variable period, often for the recipient's life, in consideration of a stipulated premium paid either in prior installment payments or in a single payment.

Defined Benefit (DB) Plan – Under a defined benefit (DB) plan, an employee's future retirement income is determined by a benefit formula specific to the retirement plan. Typically, the amount of income is based on his or her years of service with the employer and final average pay multiplied by a benefit percentage factor.

Defined Contribution (DC) Plan – Under a defined contribution (DC) plan, a specified amount of salary is contributed to the retirement account for each employee. The contributions are invested, usually according to the direction of the employee, in annuities, mutual funds, or other financial accounts that are managed by investment professionals. The amount of income at retirement will depend on the contributions made, the investment earnings achieved at the age of retirement, and the income option selected.

Interstate Reciprocity – Interstate reciprocity is when transfers are authorized between systems in different states. As of 1999, only Missouri and Texas reported the retirement system in the state was allowed to enter into agreements with comparable systems in other states for the purpose of transfer of creditable service.

Intrastate Reciprocity – Intrastate reciprocity is when transfers are authorized between retirement systems in the same state. Intrastate reciprocity is more common: several states have authorized state and certain local systems to enter into such agreements.

Pension Portability – With pension portability, workers can take their retirement benefits with them when they change employers without the value of the benefit being diminished.

Retirement Service Credits – Credited service is the employment period that is counted toward a pension. Through purchase of retirement service credit, employees who have forfeited credit in some way, either because they took leave of absences or left employment before vesting, may buy back credit.

Vesting – Once a teacher is vested, he or she has satisfied some minimum service requirement and has a right to a pension at retirement, regardless of whether he or she remains in covered employment. Employees who leave a job prior to achieving vesting generally are entitled only to their own and not their employer's contributions to the retirement plan.

ENDNOTES

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